

STATE OF SOUTH CAROLINA)

VERIFICATION

COUNTY OF UNION)

PERSONALLY appeared before me, Bryan D. Stone, who being duly sworn states:
That he is the Chief Operating Officer and Assistant Treasurer of Lockhart Power
Company; that the testimony attached hereto as Testimony of Bryan D. Stone, is based
upon information that he believes to be true and correct.

Bryan D. Stone
Bryan D. Stone

Sworn to before me this 7
day of February, 2011

Rabecka Chavis
Rabecka Chavis

My Commission Expires: January 14, 2019

Testimony of Bryan D. Stone
Docket Number 2010-181-E

1 **Q. Please state your name, business address, present position and responsibilities.**

2 A. My name is Bryan D. Stone. My business address is Lockhart Power Company, Post
3 Office Box 10, 420 River Street, Lockhart, South Carolina 29364. I am Chief Operating
4 Officer and Assistant Treasurer of Lockhart Power Company. In this role I have
5 responsibility for the company's overall performance and management.

6 **Q. Please summarize your educational background and professional experience.**

7 A. I have earned both the Bachelor of Science in Electrical Engineering Degree and the
8 Master of Science in Electrical Engineering Degree from the Georgia Institute of
9 Technology, as well as the Master of Business Administration Degree from the University
10 of Florida. I am a registered Professional Engineer in the state of Florida.

11 I began my professional career in 1990 as a Project Engineer at a 500⁺ employee
12 chemical fertilizer company near Tampa, Florida. My responsibilities involved
13 implementing nearly all electrical and instrumentation ("E&I") projects, including those
14 associated with the approximately 40 MW cogeneration plant used to convert waste
15 process heat to electricity. In 1996 I accepted a similar position at a larger company in
16 rural northern Florida. While my responsibilities were similar in nature, the scope was
17 much larger, since the new employer had 1,200⁺ employees in two chemical complexes
18 (each with its own cogeneration plant) and a mining operation, all within the same county.
19 In 2000, I was promoted to E&I Maintenance Superintendent, with responsibilities for the
20 E&I Maintenance Department, including more than 70 E&I technicians and salaried
21 employees. I had the additional responsibilities of Power Manager, which ultimately
22 included managing over \$50 million in combined power purchases and sales. In this

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1 capacity, I worked with representatives of various classes of customers, utilities, and
2 legislators on a variety of power-related issues.

3 I joined Lockhart Power Company ("Lockhart" or "the Company") in April 2006.
4 I testified before this South Carolina Public Service Commission ("Commission") in
5 Lockhart's last rate case, Docket Number 2007-33-E.

6 **Q. What is the purpose of your testimony?**

7 A. My testimony will provide a brief overview of Lockhart. With this overview as a
8 backdrop, I will describe the primary reasons why Lockhart is pursuing a rate adjustment,
9 and the reasoning behind several key aspects of the proceeding including the rate of return
10 per customer class and the cost of equity.

11 **Q. Please provide an overview of Lockhart Power Company.**

12 A. Lockhart Power Company was incorporated in 1912 by an act of the South Carolina
13 legislature. Its service area spans parts of five counties: Union, Spartanburg, Cherokee,
14 Chester and York. It serves approximately 6,300 customers, through the effort of 42
15 employees. In addition, the Company serves one wholesale customer, the City of Union.

16 The first General Manager for Lockhart was hired in 1920, and he is one of only
17 three Company leaders who have preceded me in the years since. My immediate
18 predecessor was in his position for nearly 30 years, providing a very stable long-term
19 direction for the company. His tenure was marked by a focus on tight cost control,
20 continually improving efficiency, and increasing the capacity and reliability of the
21 company's 100% renewable energy generation portfolio. He also implemented a strategic
22 focus on the core electric utility business, including overseeing the divestiture of

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1 telephone, trash, water and wastewater businesses.

2 Today, Lockhart has 18 MW of hydroelectric generation capacity on the Broad
3 River in Lockhart, South Carolina, which is also the location of its business offices. The
4 hydroelectric generation typically satisfies 20-25% of the company's load. The Company
5 also owns a 0.8 MW hydroelectric facility in Pacolet, South Carolina, and a 5.5 MW diesel
6 peaking generation station in Pacolet, South Carolina. The remainder of the power needed
7 to serve the Company's customers is purchased from Duke Energy ("Duke").

8 Lockhart purchases power from Duke at a wholesale rate which is based on Duke's
9 cost of service and which has been approved by the Federal Energy Regulatory
10 Commission (FERC). Changes in the monthly purchased power expense above or below
11 an authorized rate base amount due to load, internal generation, etc. are passed on to
12 Lockhart's customers via a flow-through purchased power adjustment clause. Purchased
13 power expense is a significant percentage of Lockhart's operating costs.

14
15 **Q. Please describe proposed changes to the Schedule "O" Purchased Power Adjustment**
16 **Clause.**

17 A. The current Schedule "O" provides the mechanism by which Lockhart flows purchased
18 power costs through to its customers, at cost. This helps ensure Lockhart's customers pay
19 a true cost-of-service based rate. Recent additions to Lockhart's generation portfolio have
20 necessitated several modifications to the Schedule "O". First, now that Lockhart has
21 existing and proposed generation assets with associated fuel costs, namely the Pacolet
22 diesel generation station and the pending Union diesel generation station (described

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below), Lockhart proposes that actual fuel and associated costs (fuel transportation, sales tax, etc.) flow through the clause to Lockhart's customers, at cost. Second, Lockhart proposes that Schedule "O" be modified to allow certain new rate base generation assets to sell power off-system, with the resulting revenues flowing through the clause as a credit to benefit Lockhart's customers. This will be beneficial to Lockhart's customers because with the Wellford Landfill Gas project (discussed below) and other similar generation projects, the maximum value for the generation in the short-term will be obtained by selling the power off-system. The revised Schedule "O" will be renamed the "Power Adjustment Clause" to reflect the broader nature of its purpose.

Q. Please provide an overview of recent changes to the Duke Energy power purchase agreement.

A. Lockhart purchases a majority of its power generation needs (75-80%) from Duke. The previous contract under which Lockhart purchased power from Duke expired at the end of 2008. The new contract was negotiated during an extended period and includes several substantive changes. First, the rate Lockhart pays Duke is calculated each year formulaically, based on Duke's actual incurred costs, helping ensure Lockhart's customers pay a true cost-of-service based rate. Second, the demand charge is now calculated based on Lockhart's power usage during the one hour period each year in which Duke reaches its system peak load (i.e. the 1 Coincident Peak or 1 CP method). This is a departure from the 12 CP method historically used, with rate-making implications described in more detail by witness Parmelee. Third, a mutually agreeable maximum peak-shaving capacity for Lockhart was identified that provides significant value for Lockhart's existing

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1 generation resources, and provides the opportunity for Lockhart to add another valuable
2 peak-shaving resource by purchasing an existing diesel peaking station from the City of
3 Union, SC.

4 **Q. Please describe the actual economic impact of the Pacolet diesel and Pacolet**
5 **hydroelectric generation resource additions described in the 2007 rate case.**

6 A. The economic benefit received by the Company's customers from the installation of the
7 5.5 MW Pacolet diesel peaking generation station in late 2006 has been significantly
8 greater than expected, due in part to changes in the contract under which the Company
9 buys power from Duke. In particular, the change from a 12 CP to a 1 CP method places
10 more economic emphasis on the demand value of the power Lockhart purchases, and less
11 on the energy value. This and other changes have resulted in an increase in the overall
12 economic value of the peaking generation of more than 30% in the last three years.
13 According to Duke's recent forecasts, there may be a similar increase over the next three
14 years. While the initial net economic benefit for Lockhart's customers was estimated to be
15 approximately \$75,000-\$80,000 per year, the actual benefit for the 2009 test year was
16 closer to three times that amount. After this rate case, the benefit will increase further,
17 based on lower than expected operating and maintenance expenses in the test year, and a
18 further depreciated basis in the facility.

19 The Pacolet hydroelectric plant has also provided greater economic benefit to
20 Lockhart's customers than projected, for the same reason. The value of the generation was
21 over 25% greater than expected, and operating and maintenance costs were less than
22 expected. In addition, the Pacolet hydroelectric purchase included an option to purchase

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1 an undeveloped "Upper" dam approximately one half mile upstream of the plant for a
2 nominal cost. After further investigating the economic case for developing the Upper
3 dam, Lockhart has determined that there will be economic benefit for its customers in
4 doing so, particularly if the project qualifies for federal American Reinvestment and
5 Recovery Act (ARRA) stimulus funds as is anticipated.

6 Both of these recently added generation sources have demonstrated their usefulness
7 in helping manage power purchase expenses. In addition, the generation has demonstrated
8 its usefulness in acting as a hedge against future purchased power price increases. The
9 experience gained in developing these generation resources and subsequently operating
10 and maintaining them has laid the groundwork for the Company to pursue additional
11 generation plant resources.

12 **Q. What are the key drivers behind the need for a base rate adjustment?**

13 A. The primary driver is recent significant capital investment in new generation, which will
14 provide both immediate and long-term net economic benefits to our customers. The
15 largest single investment is approximately \$2.5MM for the construction of a new landfill
16 gas to power project located in Wellford, SC. While the project assets will be placed in
17 rate base, the power generated will not initially be used to directly serve Lockhart's
18 customers. In order to maximize the economic benefit to Lockhart's customers, the power
19 will instead be sold initially off-system to a company that can utilize the full value of the
20 generation, including the renewable energy attributes. The off-system revenues will flow
21 back to Lockhart's customers through the revised Schedule O "Power Adjustment Clause"
22 as described above. This will provide a significant premium to the value Lockhart's

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1 customers would currently receive if they directly used the generation. The power sales
2 agreement has a ten-year term, at the end of which the then-current energy market
3 conditions will be used as the basis for whether to use the power to self-serve Lockhart's
4 customers, or to continue selling the power off-system.

5 The second largest recent investment driving the need for a base rate adjustment is
6 approximately \$1.5MM to purchase a generation station with four 1,825 kW diesel
7 peaking generators from the City of Union. Although the cost recovery for this project
8 will result in increased base rates, this increase will be more than offset, beginning
9 immediately, by a decrease in the customers' purchased power adjustment clause costs. A
10 base rate increase is therefore needed, even though the project provides immediate net
11 economic benefits to the customers. It is noteworthy that the \$1.5MM purchase price is
12 less than the \$1.8MM cost of building the Pacolet diesel generation station in 2006 using
13 similar generators, even though the Union station has 1/3 more capacity than the Pacolet
14 diesel station.

15 **Q. Please describe the Wellford Landfill Gas to Power project.**

16 A. The Wellford landfill is owned and operated by Spartanburg County ("County"), which
17 has entered into a public-private collaboration to convert the landfill methane gas ("LFG")
18 created by the landfill waste into useful energy in an environmentally friendly manner that
19 destroys this potent greenhouse gas. The County will sell and transport a portion of the
20 LFG by pipeline to a nearby private manufacturer to use as a substitute to using natural gas
21 for process heat. The remaining LFG will be purchased by Lockhart and used to fuel a 1.6

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1 MW LFG-fueled electric generator, similar in design to Lockhart's existing diesel peaking
2 generators.

3 Lockhart has entered into a long-term agreement to purchase the LFG at a
4 reasonable cost with modest escalation, protecting its customers from fuel price risk. The
5 County will own the gas collection system and the gas treatment system upstream of the
6 Lockhart's generator, significantly reducing Lockhart's capital investment when compared
7 to other projects of this type. Lockhart expects to obtain ARRA stimulus funds to offset
8 part of the project capital cost, further reducing the cost basis for Lockhart's customers.
9 Lockhart will have one person operate and maintain its equipment, as well as the County's
10 equipment (under contract), so as to reduce operating costs and risk for its customers and
11 to ensure the entire LFG system is operated and maintained to maximize the amount of
12 LFG available to generate power.

13 The LFG project will provide a net economic benefit to customers over time as
14 both the price and quantity of the generation increase..There are several factors that
15 contribute to this trend. First, the unit price of the power will contractually increase at a
16 fixed escalation rate. Second, the quantity of power generation will increase as the landfill
17 expands, until the generator is producing at its rated capacity. Third, as the plant
18 equipment depreciates, the rate of return portion of the revenue requirement will decrease.
19 Furthermore, there is upside potential should the private manufacturer pipeline customer
20 use less LFG than its stipulated cap.

21 Lockhart's parent company has agreed to forego more than an entire year's
22 dividend in order to fund this project for the benefit of its customers.

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1 **Q. Please describe the Union Diesel Generation Station Purchase.**

2 A. The 7.3 MW diesel peaking generation station ("Station") was built in 2005 and includes
3 four (4) generators and associated controls housed inside a dedicated building, four (4)
4 step-up transformers, one switching station, two (2) 15,000 gallon fuel storage tanks, and
5 related equipment all situated on 0.68 acres adjacent to an existing Lockhart substation.
6 The Station has been directly connected to Lockhart's system since its construction, so
7 Lockhart is very familiar with its generation profile and operating characteristics. The
8 generating units are nearly identical to those Lockhart purchased and installed in late 2006.
9 These factors combine to predict a low operating risk profile for the Station, coupled with
10 no construction risk since it is an existing Station. Furthermore, due to the long-term
11 positive working relationship between Lockhart and the City of Union (Lockhart's
12 wholesale customer), counterparty risk is believed to be minimal.

13 As with Lockhart's existing diesel generation resources, the new Station will
14 provide increasingly significant customer value over time. There will be immediate net
15 economic benefits to customers, as demonstrated via pro forma calculations presented in
16 testimony by Lockhart's witness Paul Inman. This immediate benefit is driven by the
17 attractive below net book value price that was negotiated. In addition, the economic
18 benefits should increase over time as the cost of purchased power demand costs from
19 Duke increase, perhaps dramatically. Therefore, the purchase of this Station will act as an
20 important cost savings measure immediately, and serve as a noteworthy hedge against
21 future wholesale rate increases.

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1 Lockhart and the City of Union have entered into a binding purchase agreement
2 dated April 29, 2009, and approval of the agreement is requested.

3 Lockhart's parent company has agreed to forego nearly an entire year's dividend in
4 order to fund this project for the benefit of its customers.

5 **Q. How has Lockhart's customer base changed since the last rate case?**

6 A. Lockhart's residential and commercial customers have decreased slightly since 2006.
7 Lockhart's industrial load, however, has dropped dramatically due to the permanent
8 shutdown of its second largest retail customers, which as recently as 2007 represented
9 more than 10% of its total sales, and more than 18% of its retail sales. Lockhart has added
10 one notable industrial customer, which has helped mitigate some of the economic impact
11 of losing the larger industrial customer. Detailed analysis related to the loss of the large
12 industrial customer is provided by witnesses Parmelee and Inman.

13 **Q. How has Lockhart's total retail revenue requirement changed since the last rate**
14 **case?**

15 A. Expert testimony by Mr. Parmelee is included in this filing that details the approach used
16 to determine Lockhart's retail revenue requirements. Lockhart is requesting a rate
17 increase of 2.5% from its current rates, which were based on a 2005 test year and became
18 effective in August 2007. Importantly, a larger increase would have been required had the
19 Union diesel generation purchase previously described not been included in this filing,
20 since as discussed it results in an immediate net economic benefit to the customers.

21 **Q. How would the Residential, Commercial, Industrial, and Lighting classes of**
22 **customers be affected if equal rates of return were applied to each class?**

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1 A. Residential customers would have an increase of 6.1%, Commercial customers an increase
2 of 8.6%, Industrial customers a decrease of 8.1%, Street Lighting an increase of 8.6%, and
3 Outdoor Lighting an increase of 9.6%.

4 **Q. Why would there be such a discrepancy between classes if an equal rate of return**
5 **approach were used?**

6 A. Over time different revenue growth rates and cost allocations between customer classes
7 can result in changes in the returns generated by each customer class.

8 **Q. Is Lockhart's requested adjustment based on an equal rate of return approach?**

9 A. No. Lockhart is using a modified equal rate of return approach, which better balances the
10 needs of the various customer classes. The modification is that a floor was set on the
11 amount of the adjustment to any class of 0%, i.e. no customer class was given a rate
12 decrease. This approach benefits the Residential, Commercial and Lighting classes of
13 customers by mitigating the increase to those classes, while still moving all classes closer
14 to the average retail rate of return. This accomplishes the dual objectives of improving the
15 fairness of the rate structure while minimizing the impact on any single class of customers.

16 **Q. What are the resulting effects on each class of customers?**

17 A. The Residential class of customers will have an increase of 3.2%, the Commercial class
18 will have an increase of 4.5%, the Industrial class will have no adjustment, and Street and
19 Outdoor Lighting customers will have an increase of 4.5% and 5.0%, respectively.
20 Despite the increases to the Residential, Commercial and Lighting classes, those classes
21 will still have rates providing a return noticeably below the retail average, while the
22 Industrial class will remain noticeably above the system average. However, the magnitude

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1 of the disparities between classes will be decreased compared to current rates, resulting in
2 a more equitable rate structure.

3 **Q. How was the cost of equity determined?**

4 A. Expert testimony by Paul R. Moul is included in this filing that details the approach used
5 to determine Lockhart's cost of equity. Mr. Moul also prepared cost of equity testimony
6 for the last rate case (Docket 2007-33-E), which was approved by the Commission. The
7 same methodology is used in this case, updated to reflect current economic conditions. I
8 would like to highlight the portion of his testimony that discusses the size premium
9 appropriate for Lockhart. Lockhart's size is literally several orders of magnitude below
10 that of its peer utilities, resulting in a dramatically higher level of risk, and a
11 correspondingly higher cost of equity. This higher level of risk is demonstrated by the
12 concentration of sales represented by a few large customers, and the earnings impact that
13 losing one of these large customers recently had on the Company. Were Lockhart to
14 request the premium adjustment for which it is qualified as a micro-cap sized company, its
15 resulting cost of equity would be 13.64%. In order to control costs for its customers,
16 Lockhart has requested a lower adjustment, corresponding to that appropriate for a much
17 larger company. The result is Mr. Moul's calculated 12% cost of equity.

18 **Q. What adjustment was made to the cost of equity as determined by the cost of equity**
19 **consultant?**

20 A. Lockhart has made a modest adjustment based on factors that are outside the scope of Mr.
21 Moul's analysis. This is a one half of one percent increase to recognize the recent
22 significant and tangible economic benefits afforded Lockhart's customers by virtue of

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1 Lockhart's unusually customer-centric performance. This performance is exemplified by
2 the two generation addition projects described previously, and the manner in which they
3 were implemented. Both projects were implemented using unusually innovative and
4 aggressive cost control measures, to enable our customers to receive immediate or near-
5 term net economic benefits from each. The long-term cumulative reduction in customers'
6 rates as compared to not pursuing the additions is dramatic. Lockhart's parent company
7 agreed to reinvest approximately two years' worth of dividends to allow this to happen.
8 These and other specific examples of Lockhart and its shareholders voluntarily going
9 "above and beyond" to achieve significant cost savings for the benefit of its customers
10 demonstrate that Lockhart should receive a modest adjustment to its cost of equity. The
11 resulting cost of equity used for this filing is 12.5%.

12 This adjustment is performance-based, using actual, recent and significant cost-
13 savings to customers resulting from the Company's efforts. It is also an incentive for the
14 Company to continue to behave in this manner, to the net benefit of its customers. This is
15 important because Lockhart's five year capital outlook includes approximately 50%
16 growth in its net plant due to discretionary, cost effective renewable energy generation
17 projects. The performance adjustment provides an incentive for the Company to strongly
18 consider implementing these discretionary projects and placing them into its regulated rate
19 base, for the economic benefit of its customers.

20 **Q. Do you have any requests concerning the timing of this case?**

21 **A.** Yes. Lockhart has recently made an investment representing approximately 10% of its
22 total company rate base on a single project (i.e. the Wellford LFG plant) to benefit its

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1 customers, despite the fact that the Company is not receiving a return on that investment.
2 Furthermore, as stated in witness Parmelee's testimony, the Company earned well below
3 its authorized rate of return during the 2009 test year. In order to mitigate the ongoing
4 negative economic impacts associated with these factors, Lockhart respectfully requests
5 an expedited review and ruling on this proceeding. Furthermore, the purchase of the City
6 of Union's diesel generator station has a contractual deadline of May 31, 2011.

7 **Q. Please summarize your testimony.**

8 A. Lockhart has recently made significant capital investments specifically to provide
9 immediate net economic benefits to its customers. Lockhart requests that the Commission
10 approve the rate adjustment and associated Schedule "O" tariff revisions as described in
11 Lockhart's rate application. Furthermore, Lockhart requests that the Wellford LFG to
12 power facility be placed in rate base, and that associated revenues flow through to
13 Lockhart's customers dollar-for-dollar via the newly revised Schedule "O". Lockhart also
14 requests that the Commission approve the diesel generation station purchase from the City
15 of Union and the associated proposed rate treatment.

16 **Q. Does this conclude your prepared direct testimony?**

17 A. Yes.